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Impact Analysis Of Mergers And Amalgamations In Public Sector Banks

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ABSTRACT

The banking industry has experienced an unprecedented level of consolidation on a belief that gains can accrue through expense reduction, increased market power, reduced earnings volatility, and scale and scope economies. A review of the literature suggests that the value gains that are alleged have not been verified. The paper seeks to address key challenges; an attempt has been made to highlight amalgamation of various public sector banks. Recently, a new thread of the literature has developed which seeks to understand individual cases, looking into the process of change for a particular merger.

Key Words: Amalgamation, Mergers, NPAs & Public sector Banks

Introduction

The government of India owns twenty-seven public sector banks (PSBs). It has often been suggested that the government should not own so many banks. Many of these banks are very small and hence, they should be merged so that they benefit from the economies of scale. The banking system continues to be dominated by Public Sector Banks (PSBs) which still have more than 70 per cent market share of the banking system assets. At present there are 27 PSBs with varying sizes. State Bank of India, the largest bank, has balance sheet size which is roughly 17 times the size of smallest public sector bank."

Most PSBs follow roughly similar business models and many of them are also competing with each other in most market segments they are active in. Further, PSBs have broadly similar organizational structure and human resource policies. It has been argued that India has too many PSBs with similar characteristics and a consolidation among PSBs can result in reaping rich benefits of economies of scale and scope. The first thing that needs to be mentioned here is that most mergers fail. There is enough research going around proving that. Hence, it is safe to say that most mergers fail and it is best to start with this assumption when any merger is proposed. And there is no reason to believe that the story for Indian public sector banks will be any different.

Types of Mergers

There have been two kinds of bank mergers in India. The first kind is when a bank which is about to **fail is merged with a strong bank.** The Section 45 of the Banking Regulation Act 1949 empowers the RBI to *"***make a scheme of amalgamation of a bank with another bank if it is in the depositors' interest or in the interest of overall banking system**.*"*The merger of Global Trust Bank with Oriental Bank of Commerce in 2004 is a good example of this. *"*Prior to 1999, most of the mergers were driven by resolution of weak banks under Section 45 of Banking Regulation Act 1949. However, after 1999, there has been increasing trend of voluntary mergers under Section 44A of Banking Regulation Act 1949."

The second kind of merger is the **voluntary merger.** As far as voluntary mergers go, a good example is the recent merger of ING Vysya Bank with Kotak Mahindra Bank. This merger had the so called synergy necessary for a merger to take place.

"One and most obvious has been voluntary merger of banks driven by the need for synergy, growth and operational efficiency in operations. Recent merger of ING Vysya Bank with Kotak Mahindra Bank is an example of this kind of consolidation. ING Vysya Bank had a stronger presence in South India while Kotak had an extended franchise in the West and North India. The merger created a large financial institution with a pan-India presence."

The merger of Bank of Madura and Sangli Bank with ICICI Bank in 2001 and 2007, and the merger of Centurion Bank of Punjab by HDFC Bank in 2008, are other good examples of synergy based mergers. If two public sector banks are merged there are bound to be situations where both the banks have a presence in a given area. Synergy will demand that one of the branches be shut down. But given that the banks are government owned something like that is unlikely to happen. Over and above this, there will be multiple people with the same skill at the corporate level. Will this duplicity of roles end, with people being fired? Highly unlikely.

Hence, the merger of two public sector banks, will give us a bigger inefficient bank. Further, there are very few examples of public sector banks being merged in the past. So, there is nothing really to learn from.

*"*Recent merger of **State Bank of Saurashtra** and **State Bank of Indore** into State Bank of India may be seen as basically merger among group companies. The only example of merger of two PSBs is merger of **New Bank of India with Punjab National Bank in 1993**. However, this was not a voluntary merger."

Also, it is worth remembering that public sector banks are facing huge bad loan problems. Many corporate who had taken on loans are not repaying them. In this scenario, if banks are merged without the bad loan problem being solved, we will have a situation where problems of two banks are basically passed on to one bank. That doesn't make the situation any better.

"PSBs as a group have not been performing well during the last few years. There has been a large increase in **Non-Performing Assets (NPAs).** As a part of managing large NPAs, some suggestions have been made that perhaps a consolidation of PSBs can render them more capable of managing such challenges relatively better...Merger of a weak bank with a strong bank may make combined entity weak if the merger process is not handled properly. The problems of capital shortages and higher NPAs may get transmitted to stronger bank due to unduly haste or a mechanical merger process."

Objectives:

To examine the need for amalgamation of PSBs.

To identify challenges and Issues in amalgamation process

Research Methodology:

The data presented in this paper is (secondary source), collected from Journals, textbooks, internet, magazines, news papers, conference books, and reports.

State Bank of India Consolidation

Through mergers with its associate banks, SBI will benefit from better reach and network, and will find itself among the world's largest banks. But it also risks ignoring local sensibilities.

The cabinet's approval on June 2015 for State Bank of India (SBI) to bring into its fold five associate banks has been hailed as a significant development that paves the way for major consolidation in the banking sector. However, it would be unwise to view such an issue only through the narrow prism of balance sheets and alleged synergies; like many developments in the financial sector, the merger of the five associate banks with SBI ought to be viewed through the proper perspective – there are positive developments but also some major negatives that must not to be glossed over.

The five banks merged with SBI are **State Bank of Bikaner and Jaipur**, **State Bank of Travancore, State Bank of Mysore, State Bank of Hyderabad and State Bank of Patiala.** SBI will also absorb Bharatiya Mahila Bank. In the past, SBI has absorbed two other associates – State Bank of Saurashtra in 2008 and State Bank of Indore in 2010. These mergers were supposed to pay the way for an accelerated phase of consolidation involving SBI and its associates, but this has not happened. The bigger hope that a fully amalgamated SBI will set the trend for all bank consolidation is clearly misplaced. Six years after SBI absorbed the Indore bank, there has been very little merger-and-acquisition activity in the banking space, and the only deal of any significance has been between private banks – Kotak Mahindra Bank acquiring ING Vysya Bank in 2015.

Some of the teething troubles encountered during the first two mergers in the SBI group have not yet been fully ironed out. For instance, the merger of the Saurashtra and Indore banks with SBI proved to be so expensive that a former chairperson of the bank went on record to say that it would not be prudent to merge more than one associate bank during a financial year. There is no evidence that a merger today will be any less expensive than those in the past. Yet, the government has thought it fit to nudge SBI and the five associate banks to merge, a process likely to be completed during the current financial year.

Many benefits, but at what cost?

Despite some issues, there are undeniable benefits from mergers within the SBI group. The avowed aim is to take SBI, already India's largest bank, into the league of the world's biggest banks. At present, no Indian bank figures in the global list of top 50 large banks. The latest round of mergers will bring SBI, with assets worth $550 billion, within striking distance of that list. On the domestic front, the merged entity will tower over other banks and will be at least four times bigger than its nearest rival.

SBI chairperson Arundhati Bhattacharya has said that the merger will result in a "win-win situation" for the bank and its associates – SBI's reach and network will multiply, efficiency will likely increase with the **rationalisation of branches,** there will be a **common treasury pooling** and there will be **proper deployment of skilled resources**. Besides, the associate banks and their customers will also benefit. **An enhanced scale of operations** and the **rationalisation of common costs** will result in **big savings**. Bhattacharya also claimed that the pooling of synergies at one place would be a huge positive.

But harnessing these post-merger benefits will not be an easy task. For one, the associate banks will not come into the SBI fold with clean balance sheets; the five banks have a higher share of restructured loans than SBI, while the levels of their non-performing assets are comparable. There will also be common borrowers, which will bring with it its own set of problems.

One of the biggest challenges for the new entity will relate to human resources issues. The combined strength of all associate bank employees is estimated at around 70,000, or a third of SBI's 210,000-strong personnel. The problem of integrating the staff is likely to be cumbersome. There are bound to be questions over seniority and given the public sector character of the banks, the courts might intervene. Pension liabilities will also surge. But with time and the cooperation of staff unions these issues can be overcome. There is, however, one significant argument against the merger of the five banks with SBI that needs to be understood in the context of regional and local sensibilities over which the merger will ride rough side.

SBI associate banks cater to specific regions, as their nomenclature indicates. State Bank of Travancore, for instance, caters to the Travancore region predominantly, although of course not exclusively, while State Bank of Hyderabad was set up as the Nizam's bank and for a long time concentrated on the old Hyderabad state. Such specialisation brings with it unique insights into local customs. Notably, SBI has had a tacit agreement not to compete with its associate banks aggressively in what were seen to be the latter's 'operation areas'. A merger resulting in a 'super' SBI may not pay heed to local sensibilities that the associates have provided. But should SBI really be growing bigger? Although the question may appear silly, size is not always positive when productivity parameters rule the roost. In these days of rapid technology absorption, a large network of branches is not necessarily a source of strength

Advantages:

The biggest advantage of merger and consolidation is the realization of benefits of scale. Merger and consolidation of public sector banks will increase their asset size and hence the capacity to finance larger projects. To take the example of SBI, it will enter the list of top 50 global banks and could become one of the anchor banks to finance large projects like the Dedicated Freight Corridor, renewable energy projects etc. thereby reducing the dependency on foreign lenders or a consortium of multiple banks. Further, there is an assumption that larger banks are less risky than smaller ones due to more diversified portfolio and hence earn a higher credit rating. Merger and Consolidation will lead to risk diversification and reduce duplication as most of the banks target same clients with almost similar products.

The move will consolidate resources and infrastructure of the banks thereby reducing the cost of operations, human resources, technology etc. It will also reduce costs of inter-banking transactions. Merger will allow banks to rationalize their bank branches and services and reduce branch overlapping. This will allow them to reach out to the unbanked areas in a cost effective manner

Challenges/Issues

One of the foremost challenges in this process of banking consolidation is the existing NPAs. Without injecting sufficient capital, the process of merger and consolidation could lead to rerouting the problem of NPAs to the new consolidated bank thereby harming its future prospects. The merger of **Global Trust Bank with Oriental Bank of Commerce in 2004** is an example of this. Mergers and consolidation will affect the Banking Competition in the economy. As per some experts India needs more banking competition than consolidation to improve the banking services in the country. Existence of excessively large banks may also create significant moral hazard costs for the entire system. A failure of a very large bank may have systemic implications and therefore, there is a perception that large banks may be bailed out during stress periods.

Finally, the process is to face considerable challenges from potential opposition from employee unions due to concerns like relocation and retrenchment due to rationalization of branches or impact on promotion prospects due to curtailment of seniority. This could hamper merger efforts and drive up costs. For example, SBI estimates that its merger with the associate banks will cost up to Rs.3 crore due to differences in employee pension schemes.

Conclusion:

While the long term benefits of the consolidation process outweigh the short term concerns, the Bank Consolidation and Merger is still a tricky issue and should be taken on a case by case basis instead of being made a general policy. It is only to be applied to right banks and in a rightly planned manner and with proper safeguards.

Also, the acquiring bank should not dominate the smaller banks. Instead good practices of both should be combined and the focus should be on synergizing the efforts of all stakeholders towards evolving a healthy banking structure.

Finally, the merger process should not only be guided by the notion that big healthy banks have to acquire small weaker banks. Other models of merger like banks with diverse regional presence etc. should be considered. For instance, merge an eastern India-focused bank with one that has strength in the south to create fewer banks with a wider network.

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